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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

1 8 1997

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

REQUEST FOR ACCEPTANCE OF LATE-FILED PLEADING

U S WEST, Inc. ("U S WEST") hereby files this request to accept its Reply Comments one business day late in the above-captioned dockets. In support of this request, U S WEST states:

1. Reply Comments in this proceeding regarding access charge reform were due for filing on February 14, 1997. U S WEST was prepared to file its Reply Comments on that date until unexpected technical problems were encountered in finalizing the document shortly before it was to be printed out, reproduced and filed with the Secretary's Office. Specifically, it appeared that the system was saving changes and edits to the document in more or less random fashion.

2. Working with U S WEST's technical support team on February 15, 1997 and February 17, 1997, the undersigned were ultimately able to identify and correct the technical problems. The problems resulted from two sources: 1) the use of a

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system-generated table of contents that resulted in certain erroneous word processing codes being embedded in the document; and 2) the use of an electronic file duplication feature that resulted in certain editing changes not being saved to the original master document. The problems completely disrupted the ability of the undersigned and their support staff to finalize the Reply Comments and print off (an uncorrupted version of) the document for filing last Friday.

3. Associated with this request for acceptance of filing today, are the attached Reply Comments of U S WEST. U S WEST asks that the Federal Communications Commission ("Commission") accept these late-filed Reply Comments.

4. U S WEST believes that its Reply Comments would be a valuable addition to the record in this proceeding, especially because U S WEST is responsive therein to specific arguments and positions advanced by various opposing parties in their opening Comments. Inasmuch as this is the Reply Comment cycle to the Notice of Proposed Rulemaking in the instant proceeding, U S WEST does not believe that any party would be harmed by the acceptance of its late Reply Comments on the first business day after February 14, 1997.

5. U S WEST regrets any inconvenience that the late filing of its Reply Comments may cause the Commission or parties to this proceeding.

Respectfully submitted,

U S WEST, INC.

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Its Attorneys

Of Counsel,
Dan L. Poole

February 18, 1997

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REPLY COMMENTS OF U S WEST, INC.

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February 18, 1997

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SUMMARY

In its Notice in this proceeding, the Commission has proposed to reform the existing Part 69 access charge structure. This reform is necessary because the existing structure is predicated on a market environment where a single provider of interstate access is assumed to provide the bulk of access services to interexchange carriers in any given geographic location. However, to the extent that assumption retained any validity entering the year 1996, such validity was shattered on February 8, 1996, by the passage of the Telecommunications Act of 1996. Now the Commission (and state commissions) are charged with the responsibility of assisting in the development of a regulatory environment which supports the development of significant competition in the local exchange marketplace. In this context, all commissions are charged with the responsibility of eliminating anticompetitive implicit subsidies and replacing them with either rebalanced, cost-based rates or support from either a federal or state universal service fund.

One area which is ripe for reform under this new law is interstate access. The access charge structure results in many prices which are significantly higher than would be the case if access were priced based on competitive market forces -- and these prices are likewise well above what is commonly called "economic cost." The Notice, fairly, wants to move access prices closer to economic cost (the Notice seems to indicate that prices should be set at cost, a proposition which U S WEST finds unreasonable). However, because of the separations process, considerably more costs are assigned to the interstate jurisdiction than would be

covered by access charges priced to reflect economic costs. Therefore, through a combination of rate rebalancing, separations reform, and universal service support, the Commission, as part of reforming access must, at the same time, ensure that incumbent LECs are not deprived of their opportunity to recover those costs which separations assigns to the interstate jurisdiction.

In these Reply Comments, U S WEST examines two types of comments which seem to mark this proceeding (and practically all others arising out of the Act). On the one hand, AT&T and MCI take a position which is, to put it kindly, utterly unreasonable. They demand that access prices be reduced to their own peculiar version of cost (which is well below any rational cost analysis), and that this reduction be immediate without any concern about the actual costs assigned to the interstate jurisdiction via separations. U S WEST points out in these Reply Comments that the AT&T/MCI position would work an unconstitutional taking of ILEC property (or would, in the alternative, require compensation for a taking of ILEC property), that it would effectuate a regulatory structure which would operate to stifle competition and investment (to the unnatural advantage of AT&T and MCI), and which would risk destruction of the local exchange telecommunications infrastructure. AT&T and MCI, by demanding that the vast scope of the problem represented by the fact that separations overassigns costs to the interstate jurisdiction simply be ignored, have in effect submitted comments which border on nonsense.

On the other hand, commentors such as Sprint have approached the issue of access reform on a measured basis which is clearly based on a desire to reach solutions. In these Reply Comments, U S WEST examines the Sprint comments in detail, finding much to agree with (and much to disagree with, as well). U S WEST and Sprint seem to agree on the necessity of reforming access charges in the context of the total market perspective, and on the essential proposition that anticompetitive subsidies (including those in local rates) must be eliminated. We also agree on many aspects of access reform -- including how to properly price services and how to charge cost-causing customers prices which reflect the price/cost relationship. We disagree on such issues as whether TELRIC should represent a cap on prices (rather than simply a projection of forward-looking cost analysis which can (and should) provide a starting point for price analysis), whether the prescriptive or market approach to access reform is preferable (U S WEST supports the market approach, Sprint the prescriptive approach), and whether high-capacity services should be priced based on the capacity relationships among the services (U S WEST opposes such a pricing structure, while Sprint prefers one).

In other words, Sprint's comments, by recognizing the fundamental economic imperatives which must guide this proceeding, have moved the process closer to what U S WEST feels is appropriate and rational resolution. Once the essential principles of cost recovery and overall regulatory symmetry (including rate rebalancing and universal service support) are recognized, the regulatory specifics the Commission uses to implement these fundamental principles become almost secondary. By the same token, failure to recognize these guiding principles would doom any regulatory structure, no matter how well constructed in the abstract, to utter failure.

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REPLY COMMENTS OF U S WEST, INC.

U S WEST, Inc. ("U S WEST") hereby submits its Reply Comments in the above-captioned docket.[1]

I. INTRODUCTION

In reviewing the comments in this docket, one thing has become patently clear -- the complex web of interrelated issues, dockets, and jurisdictions which impact together and simultaneously on the telecommunications market under the Telecommunications Act of 1996 is fundamentally seamless. Any effort to deal with these issues piecemeal would be a sure path to disaster.

Interstate access rates are currently set to recover the costs of providing telephone service which have been assigned to the interstate jurisdiction by the

[1] In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket Nos. 96-262, 94-1, 91-213 and 96-263, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488, rel. Dec. 24, 1996 ("Notice").

separations process. These are real costs. But the separations process -- which to a large extent was devised in its current version as a subsidizing device -- is a crude tool which assigns costs to the interstate jurisdiction on a basis which bears little or no relationship to cost causation. The separations process certainly bears no relationship at all to the forward-looking cost analysis which is being recommended as the touchstone for the pricing of interstate access. So this docket finds us with the separations process pumping network costs into the interstate jurisdiction at a far greater rate than would be the case if separations used the same cost principles which are proposed to guide the pricing of access. The result -- access prices based on economic costs -- would not recover all of the network costs assigned to the interstate jurisdiction via separations.

Similar dissonance appears elsewhere in the regulatory matrix which has thus far developed under the new Act. TELRIC-based prices (those preferred by the Federal Communications Commission (or "Commission")) would, if applied to the entirety of local exchange carrier ("LEC") services, not recover their entire cost of doing business. Moreover (and probably more significantly in the long run), state regulators have been adamant in insisting that local residential services should not be priced even at TELRIC, but at dramatically lower levels. (The chart on page 14 of U S WEST's initial Comments in this docket demonstrates with clarity the extent to which states currently insist that local service be priced below even the TELRIC-based rates which the Commission has determined are most economical.) We have competition entering into a regulatory environment which is predicated almost entirely on the assumption by state regulators that they need not permit competition to actually function.

Some commentors, notably AT&T Corp. ("AT&T") and MCI Communications Corporation ("MCI"), have demanded that they have the right to purchase services from incumbent LECs ("ILECs") at prices which would prohibit these ILECs from recovering anywhere near the total interstate costs of providing their services to AT&T and MCI. With all due respect, this approach is fairly close to requesting government theft of ILEC property on AT&T's and MCI's behalf. ILECs clearly have the right to the opportunity to recover their costs. But recognizing this essential principle, as important as it is, does not solve the riddle of how a regulatory structure can be established which is both lawful and rational.

We submit that the only way in which access prices (and all other communications prices) can approach economic levels is for regulators at all levels to recognize that the regulatory landscape changed dramatically with the passage of the 1996 Act. The Act itself recognizes this fact, requiring that all implicit subsidies be removed from all telephone rates (whether regulated by state commissions or the Federal Communications Commission). These subsidies can be removed in one of two ways: 1) by repricing services to above-cost levels; or 2) by maintaining below-cost service through non-discriminatory funding via a federal or state universal service fund. There are no other choices.

These principles are clearly manifest in the instant docket. It is universally recognized by all parties that there is a wide divergence between current access prices and the economic cost of providing such services. This differential is caused by a variety of factors, most of which relate to either separations, inadequate depreciation lives, or subsidies such as the carrier common line charge. None of these devices can be justified in the new telecommunications marketplace -- but the costs of these subsidies are very real costs which must be collected from somewhere. If the Commission really wants to promote a competitive marketplace, it will ensure that all of its reform dockets implementing the new Act converge around the recognition that none of its best intentions and analysis can possibly be realized so long as the system of implicit subsidies which marks the current provision of telephone exchange service remains in place. Access reform must thereby be constructed to be phased in in tandem with those necessary actions to eliminate subsidies and replace them with either rebalanced rates (at all levels, state as well as federal) or explicit and sufficient universal service support on a competitively neutral basis.

II. THE ESSENTIAL POSITION OF AT&T AND MCI IS UNREASONABLE AND CONTRARY TO LAW (NOTICE SECTIONS IV, V, VI, VII)

Analysis in this docket is made more difficult by the fact that some parties whose comments ordinarily receive a modicum of credibility -- most notably AT&T MCI -- have taken such extreme positions that they deserve no serious consideration. As a general rule, most commentors, while expressing widely divergent views, agree on two major points: interstate access must move to competitive market levels, and, as part of that movement, the Commission must deal with the fact that interstate access charges are not now at competitive market levels because of political decisions in the past that certain customers and classes of customers should receive subsidized, below-cost telephone service.

AT&T and MCI, on the other hand, simply choose to ignore this fundamental reality. They demand access prices based on costs (as they calculate them) immediately, with no provision for an intelligent transition to a reasonable market position. Their position is flatly unreasonable, and if accepted, would effectuate a confiscation of the ILECs' property and risk wrecking the nation's telecommunications infrastructure. In stating their contentions, AT&T and MCI rely on facts, analyses and legal conclusions that are palpably false. We set forth some of the more egregious misstatements herein.

A. Moving Access Charges Immediately To Forward-Looking Cost Will Stifle Local Competition (Notice Section VI)

The centerpiece of both AT&T and MCI's comments is the notion that the Commission should prescribe immediately rates for access equal to the forward-looking cost of providing access, as measured by TELRIC (AT&T)[2] or TSLRIC (MCI). The Commission must take this step, we are told, without regard to the overall impact on the telecommunications market or infrastructure, ILEC viability or competition, because the existing interstate rates are too high and are economically inefficient, because they claim that the Telecommunications Act of 1996 requires it, and because, they assert, the existing rates will provide the ILECs

[2] AT&T's "TELRIC" is neither "TELRIC" as defined by the Commission, nor a valid measure of forward-looking cost.

with a "war chest" to beat back competition.[3]

AT&T and MCI are correct on one point: the existing access charges are indeed higher than they would be in a competitive market. This is the case because access charges have been loaded with economically inefficient subsidies. Removing those subsidies and imposing the costs of local service on the cost causer (rate rebalancing) or curing implicit subsidies through the universal service fund, will permit access prices to move much closer to economically correct rates. No one would dispute this.[4]

Whether the Commission needs to do more -- and if so, what -- is largely governed by one's view of the objective. In that regard AT&T's and MCI's comments -- although they contribute nothing of merit to the debate -- serve to frame the decision the Commission faces here. In this proceeding, the Commission must choose between competition and the skewed results of imaginary competition requested by AT&T and MCI.

AT&T and MCI have weighed in with their choice. They propose a regulatory regime in which the Commission would attempt to mirror the results of some abstract notion of perfect competition. That is, they would have the Commission impose immediately what some economists see as the effects of perfect competition: prices equal to forward-looking costs. The better economic thinking, however, holds that prices would not equal forward-looking costs even in a perfectly competitive

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[3] See, e.g., MCI at i-iii, 3-4; AT&T at 3, 5, 10-12, 17.

[4] We do dispute the notion that prices in a competitive market would be capped at TELRIC or any other measure of forward-looking cost.

market because such a price structure would stifle investment, a position described by Alfred E. Kahn in Attachment A.

Even accepting, however, the view that prices might equal cost in an environment of perfect competition, universally accepted economic theory tells us that competition pushes prices only toward economic cost, not to cost. No competitor willingly prices at cost; not AT&T, not MCI, not any other interexchange carrier.[5] In real-world competitive markets, participants price to the market: they set their prices to maximize profits, and costs become a decision-making tool. Prices can equal economic cost only in hypothetical, perfectly competitive markets, in which no investment is necessary or desirable. Although all firms need to know their costs, only regulated firms price totally on some notion of cost.

AT&T and MCI urge the Commission to replicate the results of a hypothetical, perfectly competitive market because, they say, local competition is doomed to failure. In their view, competition may never amount to much, and certainly will not serve to constrain the rapacious behavior of the ILECs in the foreseeable future. Therefore, they would have the Commission drive access charges to forward-looking cost, so that the public may receive the benefits of competition.

If the Commission were to do as AT&T and MCI ask, local competition might indeed never become a reality. Put simply, an incumbent can best deter

[5] We suspect that AT&T and MCI price their own services at rates which are far higher than the Commission's TELRIC model would warrant -- and many times AT&T's and MCI's supposed TELRIC model.

competition by lowering prices to cost. Indeed, both AT&T and MCI complain that the ILECs will use pricing flexibility (particularly geographic deaveraging) to lower prices in the markets most vulnerable to competitive entry.[6] Perhaps so, but AT&T and MCI would have the Commission dictate the same result by forcing the ILECs to lower their prices even further (in all likelihood) than the ILECs would if left to their own devices. Their approach thus becomes a self-fulfilling prophecy.

And that surely suits AT&T and MCI, who obviously have little interest in providing ubiquitous local service. Indeed, if AT&T and MCI succeed here, their interests will best be served by limiting local competition. Consider:

- If ILEC access is priced at forward-looking cost, competitive entry by other local providers is unlikely to produce further overall reductions in access prices. Ubiquitous local competition thus provides no benefit to the interexchange carriers. (Indeed, if access prices are set below cost, as AT&T and MCI demand, competition will likely become untenable.)

- With no ubiquitous local competition, and under the protective umbrella of averaged prices (if AT&T and MCI have their way), large, well-financed players -- such as AT&T and MCI (which will soon have the added clout of British Telecom) -- will target large customers and/or large, low-cost cities (which generate the bulk of ILEC revenues).

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[6] AT&T at 78-79; MCI at 57. AT&T also claims (at 79-80) that deaveraging access charges would be inconsistent with Section 254(g) of the Act, which requires interexchange rate averaging, because the ILECs could enter the interexchange market only where access charges are lower and thus undercut the existing carriers' averaged rates. Yet, AT&T supports the concept of deaveraging the charges for unbundled network elements, which would allow it to do the very same thing in competing with the ILECs to provide access (see AT&T Reply to Oppositions and Comments to Petitions for Reconsideration and Clarification of First Report and Order, CC Docket No. 96-98 (November 14, 1996), at 15).

- As Professors Robert G. Harris and Dennis A. Yao have explained, this scenario will redound to the artificial market advantage of AT&T and MCI.[7]

- In the meantime, AT&T and MCI have proclaimed their intention to do everything in their power to prevent the Bell Operating Companies ("BOCs") from entering the interLATA market and thus providing a check on AT&T's and MCI's own prices.

If AT&T and MCI do intend to become ubiquitous local providers, this strategy virtually ensures that only large, well-financed players will be able to participate. To be sure, economic theory tells us that prices set artificially above cost may encourage inefficient entry. But the AT&T/MCI strategy would, if accepted by the Commission, virtually exclude all competition from the market except AT&T and MCI.

The movement of access to forward-looking cost is possible only if it is accompanied by rate rebalancing -- moving local exchange rates to economic cost. Without that, large, well-financed competitors will compete fiercely for the lucrative customers, offering integrated service packages and pricing flexibility beyond anything the ILECs can match (particularly if AT&T and MCI have their way here). The ILECs will continue to serve other customers, but with limits on their prices, facing no ubiquitous competition, and deprived of many of their most lucrative customers, they will have no incentive and even less ability to maintain and upgrade their networks. Although customers might see temporary benefits from

[7] See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Comments of U S WEST, Inc., filed May 16, 1996, Exhibit 1 at 2, 5, 7-15, 28-40.

the immediate price reduction sought by AT&T and MCI, the ultimate societal cost will be much greater.

AT&T claims that not reducing access charges to forward-looking cost will provide the ILECs with "supracompetitive" revenues to subsidize "local" services, thereby perhaps precluding the entry of a more efficient competitor.[8] But this assumes an ILEC can lose a customer's local exchange business to a competitor, (e.g., via unbundled network elements) while somehow retaining the customer's access business. AT&T does not tell us just how an ILEC might do this, and it is not readily apparent. In most circumstances, a competitive entrant will entice customers with an entire suite of local and toll services, and the price of the latter will be affected by the price of exchange access. Charging too much for access will simply drive customers away. Given that, their will be no "supracompetitive" access revenues to subsidize anything, even if access prices remain exactly where they are.

AT&T claims that new section 251(c)(2) of the Communications Act prohibits the pricing of access above cost.[9] It does not and certainly not as AT&T defines "cost." That provision obliges an ILEC to provide interconnection to any carrier "for the transmission and routing of telephone exchange service and exchange access."[10] In the Local Competition Order, the Commission determined that

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[8] AT&T at 17.

[9] Id. at 12.

[10] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 62 § 251 (c)(2)(a) (1996).

> an IXC that requests interconnection solely for the purpose of originating or terminating its *interexchange* traffic, not for the provision of telephone exchange service and exchange access to others, on an incumbent LEC's network is not entitled to receive interconnection pursuant to section 251(c)(2).[11]

In other words, section 251(c)(2) applies to interconnection for the purpose of providing exchange access, but it has no bearing on an interexchange carrier's use of exchange access to originate and terminate toll calls.[12]

AT&T also claims that pricing access above economic cost is discriminatory,[13] and thus in violation of sections 201 and 202 of the Communications Act because access is "functionally equivalent" to network elements, for which the Commission has ordered the ILECs to charge rates based on forward-looking cost. That is, interstate access prices regulated by the Commission must be set at the same level as the bi-jurisdictional interconnection prices set via negotiation and state arbitration. Under this theory, ILECs serving multiple states would be prohibited from charging a uniform price for switched access whenever state-set or approved interconnection prices are not identical to the tariffed access price. But, perhaps more significantly, AT&T's position here is radically inconsistent with its

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[11] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325, rel. Aug. 8, 1996 ¶ 191 (emphasis in original and footnote omitted) ("Interconnection Order"), appeals pending sub nom. Iowa Utilities Board v. FCC, Nos. 96-3321, et al. (8th Cir.).

[12] We agree with AT&T (at 8) that Section 254 prohibits regulatory-mandated implicit subsidies, but AT&T does not address the other half of the equation. Simply eliminating the subsidy, without rebalancing rates, will serve only to deprive the ILECs of revenue without cause or lawful authority.

[13] See, e.g., AT&T at 14-15.

contention that the prices of interconnection and unbundled network elements will have no impact on the ability of ILECs to price access at monopoly levels. If the services really are the same (and they really do look highly similar to U S WEST), there will be at least some demand elasticity and at least some cross-market price checks on access rates. Not only is AT&T's legal position wrong, it undercuts much of AT&T's posturing about the alleged unfettered ability of ILECs to manipulate interstate access prices.

Much of AT&T and MCI's demand that they be entitled to massive government-ordered price breaks is also based on their claim that ILEC networks are riddled with waste, useless investment and other diseconomies which can be sustained only in a monopoly environment.[14] This position is just wrong. U S WEST has been accused repeatedly of not investing enough in its network, including a formal complaint by MCI itself demanding that the Commission order U S WEST to spend even more money on its network. Moreover, the ILECs have an obligation to serve their customers on demand whenever and wherever the customers want. A perfectly efficient network is not possible given that obligation. There is absolutely no evidence that ILEC networks are at all wasteful -- certainly not to any material extent.

In the absence of evidence, AT&T was forced to manufacture evidence. Its approach is both startling and instructive. Through the Kravtin-Selwyn affidavit, AT&T posits the following thesis. First, AT&T developed a ratio of new lines

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[14] See, e.g., MCI at 3-4, and 8; AT&T at 31-32.

constructed compared to new capacity available from the RBOCs from 1990 to present. Kravtin-Selwyn allege that this ratio represents the amount of construction necessary to sustain basic carrier service and total service -- the remainder being either waste or construction for other purposes. Kravtin-Selwyn then apply this ratio to RBOC construction during this period and determine that a total of $30 billion spent for new facilities by RBOCs was not properly attributable to the provision of telephone service.

This approach, while patently ridiculous on its face, is even worse in the context of the technologically advancing telecommunications industry and AT&T's own position on network modernization in other contexts. As AT&T is well aware, one of the most dramatic advancements in recent telecommunications technology is the exponential increase in transmission and switching capacity (especially transmission). Any network modernization or upgrade will, at least if modern technology is used, increase network capacity by the very nature of the capabilities of the technology itself. To claim, as AT&T does, that all capacity increases not directly correlated to line increases are excessive and wasteful is to simply demand that ILECs never modernize their plant for any reason.

AT&T then turns its own silly argument on its head by claiming in CC Docket No. 96-98 that ILECs cannot receive payment for any network upgrades that do not start with the most modern technology.[15] AT&T contends that because TELRIC costs begin with the assumption that the most modern technology is

[15] See Petition of AT&T Corp. for Reconsideration and/or Clarification, CC Docket No. 96-98, Sep. 30, 1996 at 11.

already used, ILECs cannot receive payment attributed to installing the most modern technology at AT&T's behest.[16]

In short, AT&T argues that efforts by ILECs to upgrade their technology have been inherently wasteful because the most modern technology was not necessary for ILEC provision of basic services (MCI joins this argument). Thus AT&T claims that ILECs cannot recover this modernization investment. AT&T also claims, however, that ILECs cannot recover this modernization investment even when they incur it at AT&T's demand because, under AT&T's theory, they should already have made this investment.

B. By Denying The Recovery Of Embedded Costs, AT&T And MCI Would Have The Commission Confiscate The Property Of The ILECs (Notice Section VII)

Immediately reducing access charges to TELRIC or TSLRIC (as AT&T and MCI define them) will reduce the ILECs' annual interstate revenues by some $10 billion (AT&T's estimate) to $11 billion (MCI's estimate). That should raise no concerns, we are told, because some portion of that amount will be made up by the universal service fund. As for the rest of the shortfall, AT&T and MCI would have us believe the ILECs have no right to this revenue in any case.

We discuss elsewhere the flawed legal reasoning by which AT&T and MCI urge the Commission to deny the ILECs their Constitutional right to earn a

[16] See id. at 11-15.

reasonable return on the property the Commission regulates.[17] Here, we comment on the "factual" basis for AT&T's assertions.[18]

AT&T's fundamental argument rests on two points: most of the ILECs' unrecovered embedded costs are not "relevant" and the ILECs vastly understate their ability to earn on their embedded assets. In support of its first point, AT&T claims the ILECs should exclude capital expenditures for "strategic objectives and new service goals;" it chides the ILECs[19] for unnecessarily retiring analog switches in favor of digital switches and for "overspending" on central office equipment to provide second lines and discretionary services.

Assuming AT&T had any proof for these assertions,[20] they have no relevance. AT&T is presumably concerned here about capital expenditures the ILECs have made under regulation (investments made outside of regulation are not part of the ILECs' shortfall). If these expenditures enable the ILECs to earn additional revenues in excess of the costs of carrying the additional investment, the ILECs' overall shortfall is thereby reduced. Given that, we must assume that AT&T believes these investments will not have that effect -- that they were imprudent. But AT&T makes no such claim and presents no evidence to support it. Indeed, if

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[17] See Section III, infra.

[18] No such rebuttal is possible for MCI, in that it offers no factual basis for its contention (at 23-24) that "[t]he $11.6 billion in excess access revenues represents a combination of implicit subsidies, unrealized efficiency improvements, and assets acquired in preparation of entry into video and long distance markets."

[19] AT&T at 31.

[20] AT&T relies on the Kravtin-Selwyn affidavit attached to its Comments (App. B). As to that, see Section II.A, supra.

the ILECs' networks are the money machines that AT&T elsewhere claims they are, these investments must surely be paying dividends far in excess of their costs.

In fact, ILECs invest money to expand and modernize their networks so that they can meet the growing service needs of their customers and operate more efficiently. Indeed, the ILECs generally have a legal obligation to make the investments necessary to provide adequate service to their customers and can face fines and other penalties when they fail to do so. AT&T's argument simply ignores this reality.[21]

AT&T next asserts that investments made from the advent of price caps (the beginning of 1990) should be disregarded. From that point on, the ILECs could have "no legitimate shareholder expectation of embedded cost recovery."[22] AT&T does not tell us exactly <u>why</u> this is so, and it is again far from obvious. To be sure, the Commission changed the way in which it regulated the price-cap ILECs in 1990, but it did not deregulate them. The ILECs' rates are (and always have been) subject to ongoing control and limitation by the Commission and the state commissions, and nowhere did any regulator warn the ILECs to cease making new investments, lest they lose their money. Indeed, the regulators frequently have

[21] Perhaps most incomprehensible is the fatuous notion that second lines are something other than "basic service."

[22] AT&T at 32.

required the ILECs to make investments to enhance the quality of service or to bring innovations into the network.[23]

And, assuming the ILECs were prescient enough to see the coming of competition six years before Congress passed the 1996 Act, what would AT&T have had them do about it? Should they have stopped investing? Such a Luddite mentality is not well calculated to provide "to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities."[24] Moreover, as AT&T is well aware, regulators have not permitted U S WEST to stop investing. The notion that price cap regulation is the equivalent of deregulation (or alleviation of traditional common carrier obligations) is simply wrong.

In any event, says AT&T,[25] the ILECs have had plenty of opportunity to seek revised depreciation schedules. Perhaps. But the outcome of these "opportunities" is governed by the regulators. The ILECs do not set their own depreciation rates, and that they have sought shorter lives -- which U S WEST most assuredly has -- and been denied affords no excuse simply to deny them the recovery of their investment. In point of fact, AT&T's competitive depreciation lives are materially shorter than those prescribed by the regulators for the ILECs.

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[23] For example, the Commission required the ILECs to invest the money necessary to provide 800 database access services. Report and Order, Provision of Access for 800 Service, 4 FCC Rcd. 2824 (1989).

[24] 47 U.S.C. § 151.

[25] AT&T at 32-33.